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H. R. 3574

[Report No. 108–]

To require the mandatory expensing of stock options granted to executive officers, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 21, 2003

Mr. BAKER (for himself, Ms. ESHOO, Mr. DREIER, Mr. KENNEDY of Minnesota, Mr. HONDA, Mrs. TAUSCHER, Ms. LOFGREN, and Mr. CANTOR) introduced the following bill; which was referred to the Committee on Financial Services

JUNE , 2004

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in italic]

[For text of introduced bill, see copy of bill as introduced on November 21, 2003]

A BILL

To require the mandatory expensing of stock options granted to executive officers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Stock Option Accounting Reform Act".

SEC. 2. MANDATORY EXPENSING OF STOCK OPTIONS HELD BY HIGHLY COMPENSATED OFFICERS.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

"(m) MANDATORY EXPENSING OF STOCK OPTIONS.—

"(1) NAMED EXECUTIVE OFFICER.—As used in this subsection, the term 'named executive officer' means—

"(A) all individuals serving as the chief executive officer of an issuer, or acting in a similar capacity, during the most recent fiscal year, regardless of compensation level; and

"(B) the 4 most highly compensated executive officers, other than an individual identified under subparagraph (A), that were serving as executive officers of an issuer at the end of the most recent fiscal year.

"(2) IN GENERAL.—Subject to paragraph (4), every issuer of a security registered pursuant to section 12 shall show as an expense in the annual report of such issuer filed under subsection (a)(2), the fair value of all options to purchase the stock of the issuer

granted after December 31, 2004, to a named executive officer of the issuer.

"(3) FAIR VALUE.—

"(A) IN GENERAL.—The fair value of an option to purchase the stock of the issuer that is subject to paragraph (2) shall—

"(i) be equal to the value that would be agreed upon by a willing buyer and seller of such option, who are not under any compulsion to buy or sell such option; and

"(ii) take into account all of the characteristics and restrictions imposed upon the option.

"(B) PRICING MODEL.—To the extent that an option pricing model, such as the Black-Scholes method or a binomial model, is used to determine the fair value of an option, the assumed volatility of the underlying stock shall be zero.

"(4) EXEMPTIONS.—

"(A) SMALL BUSINESS ISSUERS.—This subsection shall not apply to an issuer, if—

"(i) the issuer has annual revenues of less than $25,000,000;

"(ii) the issuer is organized under the laws of the United States, Canada, or Mexico;

"(iii) the issuer is not an investment company (as such term is defined under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3));

"(iv) the aggregate value of the outstanding voting and non-voting common equity securities of the issuer held by non-affiliated parties is less than $25,000,000; and

"(v) in the case of an issuer that meets the criteria in clauses (i) through (iv) and is a majority-owned subsidiary, the parent of the issuer meets the requirements of this paragraph.

"(B) DELAYED EFFECTIVENESS.—The requirements of this subsection shall not apply to an issuer before the end of the 3-year period beginning on the date of the completion of the initial public offering of the securities of the issuer, and shall only apply to an option to purchase the stock of an issuer granted after such date.".

SEC. 3. PROHIBITION ON EXPENSING AND ECONOMIC IMPACT STUDY.

(a) PROHIBITION.—Section 19(b) of the Securities Act of 1933 (15 U.S.C. 77s(b)) is amended by adding at the end the following:

"(3) PROHIBITION ON EXPENSING STANDARDS.—

"(A) IN GENERAL.—The Commission shall not recognize as 'generally accepted' any accounting principle relating to the expensing of stock options unless—

"(i) it complies with the requirements of subparagraph (B); and

"(ii) the economic impact study required under section 3(b) of the Stock Option Accounting Reform Act has been completed.

"(B) REQUIREMENTS.—A standard referred to in subparagraph (A) shall require that—

"(i) if an option to purchase the stock of an issuer that is subject to the requirements of section 13(m) of the Securities Exchange Act of 1934 is exercised—

"(I) any expense that had been reported under that section 13(m) with respect to such option shall be recomputed as of the date of exercise and

shall be equal to the difference between the price of the underlying stock and the exercise price; and

"(II) to the extent the recomputed amount differs from the amount previously reported under section 13(m) with respect to such option, the difference shall be reported in the fiscal year in which the option is exercised as a reduction or increase, as the case may be, of the total expense required to be reported under that section 13(m) during that fiscal year;

"(ii) if an option to purchase the stock of an issuer that is subject to the requirements of section 13(m) of the Securities Exchange Act of 1934 is forfeited or expires unexercised, any expense that had been reported under that section 13(m) with respect to such option shall be reported in the fiscal year in which the option expires or is forfeited as a reduction of the total expense required to be reported under that section 13(m) during that fiscal year; and

"(iii) to the extent that any reduction required under clause (i) or (ii) exceeds total option expenses for any fiscal year, such excess shall be reported as income with respect to options to purchase the stock of the issuer.".

(b) ECONOMIC IMPACT STUDY.—Not later than 1 year after the date of enactment of this Act, the Secretary of Commerce and the Secretary of Labor shall conduct and complete a joint study on the economic impact of the mandatory expensing of all employee stock options, including the impact upon—

(1) the use of broad-based stock option plans in expanding employee corporate ownership to workers at a wide range of income levels, with particular focus upon non-executive employees;

(2) the role of such plans in the recruitment and retention of skilled workers;

(3) the role of such plans in stimulating research and innovation;

(4) the effect of such plans in stimulating the economic growth of the United States; and

(5) the role of such plans in strengthening the international competitiveness of businesses organized under the laws of the United States.

SEC. 4. IMPROVED EMPLOYEE STOCK OPTION TRANSPARENCY AND REPORTING DISCLOSURES.

(a) ENHANCED DISCLOSURES REQUIRED.—Not later than 180 days after the date of enactment of this Act, the Commission shall, by rule, require each issuer filing a periodic report under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)) to include in such report more detailed information regarding stock option plans, stock purchase plans, and other arrangements involving an employee acquisition of an equity interest in the company. Such information shall include—

(1) a discussion, written in "plain English", in accordance with the Plain English Handbook published by the Office of Investor Education and Assistance of the Commission, of the dilutive effect of stock option plans, including tables or graphic illustrations of such dilutive effects;

(2) expanded disclosure of the dilutive effect of employee stock options on the issuer's earnings per share;

(3) prominent placement and increased comparability and uniformity of all stock option related information;

(4) the number of outstanding stock options;

(5) the weighted average exercise price of all outstanding stock options; and

(6) the estimated number of stock options outstanding that will vest in each year.

(b) DEFINITIONS.—As used in this section:

(1) COMMISSION.—The term "Commission" means the Securities and Exchange Commission.

(2) ISSUER.—The term "issuer" has the meaning provided in section 2(a)(7) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201(a)(7)).

(3) EQUITY INTEREST.—The term "equity interest" includes common stock, preferred stock, stock appreciation rights, phantom stock, and any other security that replicates the investment characteristics of such securities, and any right or option to acquire any such security.

SEC. 5. PRESERVATION OF AUTHORITY.

Nothing in this Act shall be construed to limit the authority over the setting of accounting principles by any accounting standard setting body whose principles are recognized by the Securities and Exchange Commission under section 19(b)(1) of the Securities Act of 1933 (15 U.S.C. 77s(b)(1)).

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